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ABSTRACT

In accordance with a Legislative Budget and Audit Committee special request and the provisions of Title 24 of the Alaska Statutes, a review was conducted of the Alaska Commission on Postsecondary Education's experience with various collection contractors used to collect defaulted student loans. The primary purpose was to assess the success that private contractors have had in collecting student loans. The report begins with descriptions of the Alaska Student Loan Program, the Alaska Student Loan Corporation, and two collection agencies: Collect Alaska Network, Inc.; and Patterson and Van Abel. A historical background of the situation of defaulted loans is presented, along with an analysis of the gap in processing past due accounts, the default rate, prospective policy and approach, and attachment of permanent fund dividends. Information regarding collection proceeds and costs is also provided. Recommendations are made for improving internal controls involving collection contracts, and for further developing and implementing a policy for identifying and writing off uncollectible student loan accounts. The Commission's response to the findings and recommendations is attached. (JDD)

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A SPECIAL REPORT ON THE ALASKA COMMISSION ON POSTSECONDARY EDUCATION COLLECTION OF DEFAULTED STUDENT LOANS
August 15, 1988

Audit Control Number

05-4315-88-S

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BUDGET AND AUDIT COMMITTEE

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August 15, 1988

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

A SPECIAL REPORT ON THE
ALASKA COMMISSION ON POSTSECONDARY EDUCATION
COLLECTION OF DEFAULTED STUDENT LOANS
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Randy S. Welker, CPA
Legislative Auditor
Division of Legislative Audit

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PURPOSE OF THE REPORT

In accordance with a Legislative Budget and Audit Committee special request and the provisions of Title 24 of the Alaska Statutes, we conducted a review of the Alaska Commission on Postsecondary Education's (ACPE) experience with various collection contractors used to collect defaulted student loans. Our primary purpose was to assess the success that private contractors have had in collecting student loans. In addition, we reviewed the prospective change in approach and policy adopted by ACPE regarding the collection of defaulted loan accounts.

ORGANIZATION AND FUNCTION

The Alaska Commission on Postsecondary Education (ACPE) is made up of 14-members, representing various interested groups or constituencies in postsecondary education. By statute, the commission is comprised of 2 individuals representing the University Board of Regents, 2 legislators, 4 individuals from the general public, and one representative each from the State Board of Education, Council on Community Colleges, proprietary schools, private higher education, vocational education, and postsecondary students.

The commission staff of 64 performs three main functions: (1) coordination and advisory agency for postsecondary education, (2) administration of various student assistance programs, and (3) regulation of the State's public and private postsecondary institutions and programs.

Commission members play a limited role in the day-to-day operations of ACPE, relying on staff to carry out and manage its various functions and programs. The commission does take an active role in setting general operating guidelines and making recommendations to staff regarding major policy decisions.

Alaska Student Loan Program

The Alaska Student Loan Program (ASLP) is the largest of the student assistance programs administered by ACPE. ASLP has provided over $300 million in student loans since 1971. Loans are limited to $5,500 and $6,500 per year for undergraduate and graduate study respectively. Loans are to be used only to offset the costs of tuition, room, board, and books, and provide the borrower with a ten-year repayment period at 8% interest, unless the loan becomes 120 days past due. At that point interest is computed at 10% for the period the loan is in default.

Loans may be issued for full-time attendance at any accredited or approved college, university, or vocational-technical program. Borrowers who received loans prior to July 1, 1987 and remain in or return to the state after completing their programs of study, are eligible for a 50% cancellation provision. This provision was repealed in 1987.

Alaska Student Loan Corporation

The Alaska Student Loan Corporation was created in 1987 to improve higher educational opportunities of residents of the State of Alaska, and is administered by the Alaska Commission on Postsecondary Education. The corporation is governed by a board of directors consisting of two members

of the Alaska Commission on Postsecondary Education, the commissioner of revenue, the commissioner of administration, and the commissioner of commerce and economic development. To fund student loans for academic years 1987-1988 and 1988-1989, the corporation has sold tax exempt bonds. The first bond issue totalling $83,795,000 was sold in May and June of 1988.

Collect Alaska Network, Inc.

Collect Alaska Network, Inc. (CAN) is a Fairbanks collection agency which has been in business for about twenty years. CAN has been a contractor for collecting on defaulted student loans since 1987. CAN's primary goal for borrowers in default is to bring the borrower current and to convince the borrower to remain current. The first step in achieving this goal is to establish communication with the borrower. CAN aims to convey to the borrower the importance of repaying a debt without alienating the individual.

Patterson and Van Abel

The Anchorage law firm of Patterson and Van Abel (PVA) has been a contractor for collecting on defaulted student loans since 1984. They did not bid on the current contract covering the calendar year 1988. The first action taken on accounts in default which are transferred to PVA is to file litigation and this is used as incentive for the borrower to bring their account current.

REPORT CONCLUSIONS

Initially, the Alaska Commission on Postsecondary Education (ACPE) was satisfied with the performance of the contractors used to collect defaulted student loans. The contractors provided a cost effective means for making some collections that otherwise would not have been made.

Three factors led ACPE to re-examine both their general policy and the specific terms of the contracts for collection of defaulted accounts. First, complaints from disgruntled borrowers increased. Many of the complaints stemmed from the manner in which their defaulted loans were handled by the contractor. Borrowers felt they were not being treated fairly by ACPE because they did not receive past due notices prior to commencement of legal action. Secondly, the default rate started to rise in mid-1986 and continued to rise despite contractors' efforts. Finally, the adoption of 1987 legislation allowing for the attachment of the permanent fund dividend checks for individuals with defaulted student loans profoundly changed the nature of the collection effort and its anticipated costs and benefits.

At the time that contractors were first used to collect defaulted loan accounts, ACPE eliminated their in-house borrower contact and tracing efforts in response to legislative intent. These cutbacks created a "gap" in the manner that past due accounts were processed. By severely restricting their in-house efforts to trace and contact past due borrowers prior to transfer for collection, ACPE created a discontinuous collection process which hampered the contractors' subsequent collection efforts and oftentimes created resentment on the part of borrowers who felt they were not being treated fairly.

ACPE identified this "gap" and felt that it was the cause of much of the borrower resentment and contributed to the loan fund's high default rate. Efforts to structure a collections contract to fill the gap failed; collection contractors have been either unable and/or apparently unwilling to hire sufficient staff to "work" transferred loan accounts in a comprehensive manner.

The authorization to attach the permanent fund dividend (PFD) checks to satisfy defaulted student loans resulted in unprecedented increases in both the collection proceeds and costs to the borrower and the state. ACPE felt the contractors were not justified in receiving such a large "windfall" when the state performed a large part of the work needed to perfect the attachments.

In response to these circumstances, ACPE has developed a different approach to the collection of defaulted loan accounts. Beginning with both the new collections contract signed in June 1988 and the agency's FY 89 operations, ACPE extensively modified their loan collection approach. Through a combination of increased staff, an altered fee structure, and more specific contract language, ACPE is attempting to develop a more comprehensive, effective, and efficient collection process. Litigation is still an important aspect of the collection process but under the terms of the current contract, litigation will not be the first step in the collection process, but rather will be implemented only after a prescribed effort to contact the borrower has been made.

Based on review of ACPE's past experience with contractors and our analysis of the collections made by the contractors used during 1985-1987, we concur with ACPE's change in approach. This new tack towards collection of defaulted student loans appears to us to be good public policy which will: (1) provide for more cost effective collections; (2) promote and improve borrower relations; and (3) provide more effective management of the Alaska Student Loan Program's default rate.

AUDITOR'S COMMENTS

Following is further discussion of our observations and comments regarding the key circumstances cited in the Report Conclusions section of this report:

The Gap in Processing Past Due Accounts

Through their experience with various contractors, ACPE has become increasingly convinced that an effective past due payment collections process involves labor intensive work such as: (1) ongoing attempts to locate and contact borrowers as their accounts become past due; (2) "skip tracing" of borrowers who change addresses without notification; and (3) establishing personal contact with past due and defaulted borrowers to discuss with them various possible deferments or waivers that might be appropriate to their personal situation.

During 1985 through 1987 ACPE was not successful in promoting such a comprehensive and ongoing collection effort through the use of their contractors. As discussed further in both the Historical Background and Collection Proceeds and Cost sections of this report, inadequate staffing on the part of both ACPE and the contractors resulted in an inconsistent and often erratic collection effort.

Default Rate

The use of contractors to collect student loans has not lowered the default rate for the Alaska Student Loan Program. Although concern about the program's default rate was not a major consideration in the decision to contract for collections, it has become an increasingly important concern and a key measure of public policy decisions.

In the early period of the collection contract, the default rate declined. However, since mid 1986, the default has risen from approximately 14% to over 18%. The size of the default rate has taken on more significance with the establishment of the Alaska Student Loan Corporation and the sale of bonds to fund student loans. Due to this development the use of contractors and their effectiveness at lowering the default rate has become a more important factor in decision-making regarding collection of defaulted student loans.

Prospective Policy and Approach

ACPE's FY 89 budget provides funding for additional staff that will use available loan information to skip trace and contact past due borrowers. ACPE now believes, and we

concur, that a key element of a successful collection effort involves the development of a consistent, ongoing attempt to locate and maintain contact with borrowers before their accounts become delinquent. By bringing this effort back "in-house" ACPE believes they can better manage their past due accounts and therefore their subsequent defaulted accounts.

ACPE, with funding and approval from the legislature, has developed a hybrid approach to defaulted loan collections. This approach utilizes increased state staff resources to more intensively "work" loans before they enter default status while still utilizing private collection contractors to seek out, contact, and possibly litigate the more difficult default cases.

Attachment of the Permanent Fund Dividends

Collection of over $1.75 million on defaulted student loan balances was made as a result of the attachment of the PFDs during the first year of implementation. (See the Historical Background section of this report for more information about the attachment.) The primary reason that 1987 PFD attachments proved so effective was the element of surprise. It is our observation from hearings and reading hearing officer decisions [Administrative Procedures Act (APA) procedures were required for all recipients contesting the state attachment of their PFD] that many individuals who were in default of their student loans were caught unaware that their PFD would be attached.

Attachment of 1988 PFDs may not prove to be as successful. Individuals, who still have large remaining defaulted loan balances may elect not to file for their 1988 PFD at all knowing that they will not receive any direct benefit. The legislature may want to provide for some restructuring of PFD attachment legislation to maintain an individual's incentive to file.

During the 1988 session, legislation passed the House of Representatives (HB223) which allowed individuals to receive and retain $100 of their PFD, no matter what attachments may be outstanding against them. If such legislation is introduced again, the legislature may want to additionally consider allowing an individual to receive their $100 payment only after the PFD has been assigned to the State, avoiding the costs associated with attachment.

Such a provision would essentially result in the individual waiving their access to due process under the APA in exchange for receiving $100 of their PFD. During 1987 ACPE spent over $55,000 processing APA hearings for more than 750 individuals. In decisions issued by an independent hearing

officer, less than 5 of these individuals were found to have a legitimate defense against the attachment. Legislation that would grant individuals $100 in exchange for a simple assignment and waiver of their due prccess rights could reduce this administrative cost of attachment significantly.

HISTORICAL BACKGROUND

The Alaska Student Loan Program (ASLP) is one of the most generous loan programs in the State with no comparable program in the nation. Borrowers are not required to demonstrate fiscal responsibility, financial need, or an ability to repay in order to receive a loan. Due in large part to these generous terms, the ASLP has grown from making 1,000 loan awards during 1971-72 to the award of 16,000 loans during 1987 - 88. Figure A at right illustrates the generally steady increase in number of new loans awarded each year in addition to the steep increase in the number of loans entering repayment status. (The shaded area of the graph highlights the period in which decisions to contract for the collection of student loans were made.)

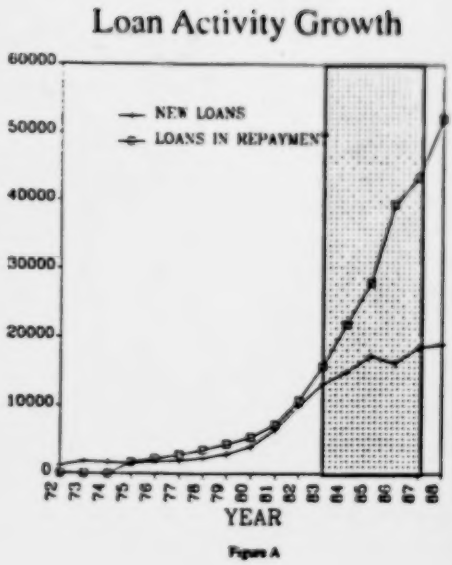

Figure A

ACPE Asks for More Staff

The rapid growth of the ASLP resulted in budget requests for increased staff by ACPE. The legislature repeatedly turned down ACPE requests (reaching a high of 37 positions in the agency's FY 84 budget request) for additional staff to handle the processing of the near geometric increase in the number of loans entering repayment. As a result, the number of loan accounts in repayment as compared to ACPE's existing repayment staff increased dramatically between 1983 and 1987. (See Figure B at right.)

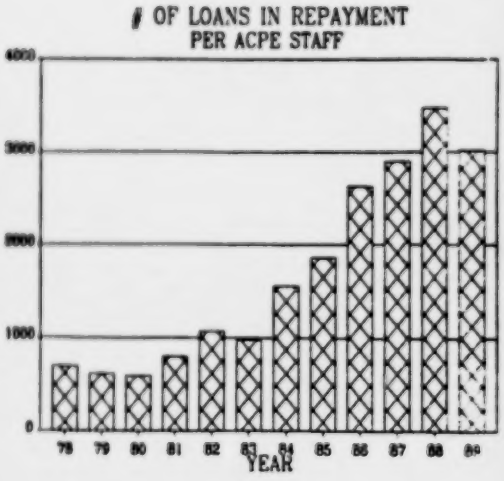

Figure B

The size of the requested staffing increases raised questions regarding whether or not loans could be serviced more efficiently by private sector financial institutions. Accordingly, the 1983 Legislature directed that the repayment and collection sections of the ASLP be converted to a cost-efficient contract service during FY 84. The legislature reiterated its intent in ACPE's FY 85 budget stating, ". . . ACPE shall attempt to enter into a full or partial year contract for servicing student loans. . ."

Loan servicing involves two interrelated but distinct processes: repayments and collections. Typically, repayment processing involves routine work which includes identifying and contacting borrowers whose accounts are current and/or less than 120 days past due. After the account is more than 120 days past due, the account is declared to be in default, and is then transferred to collections.

Collection efforts center around trying to bring the account current and if that fails, processing appropriate litigation against the borrower to satisfy the debt. Both repayment and collection activities are labor intensive, requiring personal contact with the borrower to keep them current, or if the borrower is in default, convincing them to become current. ACPE staff performed both of these aspects of loan processing and felt that to be effective, staff would have to be expanded to handle the increasing workload brought on by the rise in the number of loans entering repayment.

Attempts to Privatize Loan Repayment and Collections

In response to the legislative intent, on two separate occasions requests for proposals (RFPs) were issued in order to solicit contractors to service student loans. All responses to both RFPs were determined to be inadequate because no respondent's proposal was found to be "cost-efficient" as set out in the FY 84 budget intent language.

Due in large part to legislation passed during the 1984 session, ACPE was able to split the loan servicing functions and developed an apparent cost effective contract for the collection of defaulted student loans. This third, reduced scope RFP focussed on litigation as the means to successfully collect on the defaulted accounts. Of the thirteen respondents to the RFP, five were law firms.

Apparently ACPE felt that improved litigation services were needed to successfully pursue defaulted borrowers. In the past, ACPE had become frustrated by the inability of the Department of Law to provide timely legal action for the ASLP due to the volume of borrowers in default. The Anchorage law firm of Patterson and Van Abel (PVA) was awarded the first collections contract, which covered the period from September 1984 through September 1985.

Patterson and Van Abel

PVA's approach for collecting on the defaulted student loans involves filing suit on defaulted borrowers upon receipt of their account from ACPE. Then using the suit as leverage, PVA attempts to convince the borrower to repay the loan in order to avoid further legal action. In the first transfer of accounts, ACPE sent PVA over 3,000 loans. PVA initiated legal action. In fact, due to the huge volume of complaints

filed by PVA, the state courts in Anchorage became backlogged and it took months for all the complaints to be processed.

In retrospect, it is clear that neither ACPE nor PVA were adequately prepared to effectively handle and collect the first group of 3,000 accounts. When ACPE contracted for student loan collections, the agency shifted staff who were involved in contacting borrowers and skip tracing to handling strictly repayments. This shift left a gap in the loan servicing process. Although ACPE continued to mail notices to past due borrowers, they did not have the staff to follow up and directly contact all borrowers prior to their account being transferred for collection. Nor was there any provision requiring the contractor to attempt to locate and contact defaulted borrower prior to the commencement of legal proceedings.

Concerns Over PVA Procedures

As time went on, defaulted borrowers repeatedly complained to ACPE, the ACPE staff, and the Ombudsman, that PVA had neither the interest nor the staff to administer repayments to bring the defaulted loans current. Concerns regarding PVA's techniques and procedures began to develop. At their March 1986 meeting an ACPE member requested an explanation of PVA's procedures, including examples of correspondence sent to borrowers.

Consequently, at ACPE's May meeting PVA gave a presentation describing their collection/legal process and procedures. At that meeting, the executive director of ACPE reported that borrowers were complaining about the handling, or lack thereof, of their accounts when they were turned over to PVA. After hearing the presentation and report, the Commission directed ACPE staff to prepare an evaluation of the collections program for the September meeting, including ". . . how the system is working and where it is going."

By the September 1986 ACPE meeting, the Commission had determined that the existing contract was not effectively accomplishing all aspects of the intended collection process. They directed staff to prepare an amended RFP for loan collections, which emphasized pre-litigation techniques in addition to legal remedies and approaches. ACPE wanted to solicit contractors who would perform functions similar to those that ACPE staff had done prior to the privatization of the collection process. They wanted to find a contractor who would locate, contact, and try to bring current those borrowers whose accounts were 60 to 90 days past due.

Consequently, an RFP addendum was prepared which stipulated that bidders provide detailed plans for addressing three areas of primary concern:

1. Out-of-state debtors
2. Skip-locate/pre-litigation effort
3. Default litigation

In order to attract as many potential respondents as possible, the addendum also provided for a more generous fee structure. Now, instead of the defaulted borrower bearing the total amount of the collection costs, the State would pay a portion of the increased fee. The State, recognizing, ". . . the default debtor's finite financial resources and increasing costs of collection. . .", proposed to equally share the cost of collection with the debtor. Under the terms of the revised RFP, contractors could charge fees of up to 30% of the default balance, with the borrower paying 15% and the ASLP paying the other half. The two successful bidders both negotiated final fees of 22%.

Besides revising the RFP, ACPE also decided to contract with two vendors in order to better assess PVA's techniques and effectiveness by comparing their success and operation to a different vendor. This decision reflected some of the misgivings that ACPE had developed regarding PVA's approach to collections. Furthermore, by awarding some of the collections accounts to a second vendor, ACPE felt they would perhaps accomplish their desire for more extensive pre-litigation collection efforts. The second contractor selected was a Fairbanks firm, Collect Alaska Network, Inc. (CAN). The contract period was from January to December 1987.

Collect Alaska Network and the 1987 Contract

CAN uses a different approach for collection of past due accounts. In contrast to PVA's technique, CAN regards use of legal action as a last resort to collect on a bad debt. They feel that contacting and counseling the delinquent borrower about the importance of repaying the debt and working with the borrower to set up viable repayment schedules is, in the long run, a more cost efficient way to bring and keep delinquent accounts current.

The introduction of a second contractor did not result in increased personal contact with defaulted borrowers. Our review of a sample of loans accounts currently held by the two contractors confirmed the general lack of consistent and/or persistent contact. Half of the transferred accounts reviewed indicated that the contractor had made very limited or no contact with the defaulted borrower. As was the case with PVA, CAN did not and currently does not have adequate personnel to provide the ongoing, consistent working of accounts; a process made even more difficult since they do not receive the accounts until they are already more than 120 days past due.

Use of two contractors did provide for some comparison of the two collection styles. One real difference, not readily measurable in direct costs, was identified and documented. Borrower complaints regarding the procedures of the two contractors all involved the manner in which PVA administered collection of their accounts.

Attachment of the Permanent Fund Dividends

In 1987 the legislature extensively revised the terms and conditions of loans made by the ASLP. One result of this revision was to authorize ACPE to attach permanent fund dividend (PFD) checks for those individuals whose student loans were in default. Now collection contractors, who had struggled to collect from elusive borrowers, had a very effective means of locating many individuals and extracting funds to apply to defaulted loan accounts and payment of collection fees.

While the attachment provision increased the amount of collections, the provision, which was unanticipated at the time the contracts were originally signed, also provided a "windfall" for the collections contractors. All proceeds realized from the attachment of the PFD check were subject to the 22% fee structure: 11% of the fees were borne by the ASLP, even though the effort expended by the contractors was relatively minimal. In fact, as shown in the Collection Proceeds and Costs section of this report, ASLP incurred most of the costs, both direct and indirect, associated with attachment of the PFDs.

Prospective Policy

ACPE's FY 89 budget request and new collection services RFP reflected the agency's most recent approach to developing a more effective collections process, which will hopefully result in the lowering the default rate. Key elements of ACPE's new approach are as follows:

1. Expanded in-house, pre-default collection efforts. Based on ACPE's experience with various contractors and approaches, the agency has determined that it is important to reestablish consistent contact with borrowers whose accounts are past due, but not yet in default status (that is, more than 120 days past due).

   Rather than attempt to promote more pre-default contact by contractors, in their FY 89 budget ACPE requested and received 6 additional staff positions to "work" these past due, but not yet defaulted, accounts. ACPE believes this new staff will allow ACPE to better maintain contact with past due borrowers prior to the accounts being in default.

2. Application of the PFD attachments to defaulted loan balances. ACPE's RFP for 1988 collection services was extensively rewritten. The most significant change to the terms of the new contract prohibits the collection contractor from retaining any collection fees out of PFD attachment proceeds. This will allow ACPE to realize and apply a greater portion of the PFD attachment proceeds to defaulted accounts, generally reducing the number and dollar amount of loans in default.

3. More selective use of legal remedies. The new RFP also recognizes legal action may still have to be taken, but only after a prescribed, concerted effort is made to locate the defaulted borrower. Legal remedies will be sought only after other extensive collection efforts have been applied.

This new collections approach reflects what ACPE has learned from their experience to date with privatization. The commission has come to realize that immediate legal action is not necessarily the most effective way to collect defaulted accounts. The political outlook of the commission, the increased costs to the borrower, in addition to an individual's generally negative reaction to legal documents and procedures, have led ACPE to reexamine the use of litigation.

COLLECTION PROCEEDS AND COSTS

During the three year period that private sector contractors collected defaulted student loans, both the defaulted borrower and the State were charged various costs and fees.

The table below presents information regarding collections:

	Total Collection Proceeds	Borrower Fees & Costs	State Fees & Costs
1985	$ 728,367	$112,550	$ 42,295
1986	718,865	100,469	25,624
1987	2,986,359	461,064	287,502
Total	$4,433,591	$674,083	$355,421

Figure C indicates that even though the contract was not "cost free" to the state as ACPE had originally believed, the amount of fees paid out was still relatively small compared to the proceeds collected in 1985 and 1986.

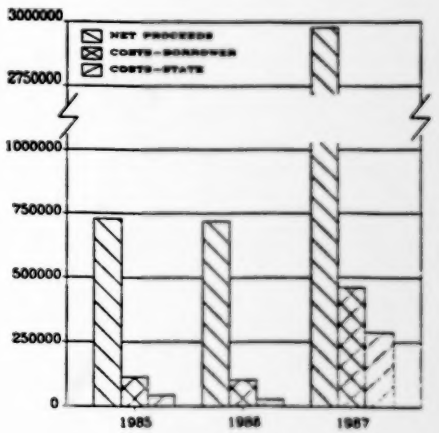

Figure C

The significant increase in collection activity during 1987 was largely a result of the new legislation which authorized the attachment of PFD checks. (See Historical Background section of this report for further discussion of this legislation.)

Figure D compares funds collected through previously used collection methods for 1985 - 1987, with the amount collected as a result of 1987 PFD attachments. The fees paid by the State for the PFD attachment proceeds essentially represented a "windfall" to the contractors, while the layer of indirect costs (the checkered portion of the 1987-PFD state costs) represents over $75,000 in State expenditures associated with following the procedures necessary to attach the PFD funds.

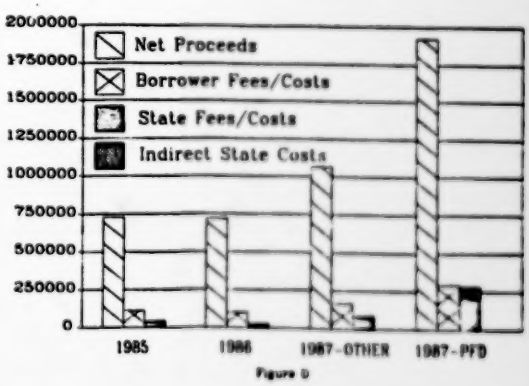

Figure D

The collection contractors realized a large increase in fees compared to previous years largely due to the proceeds of the PFD attachments. However, it was the State that primarily paid the costs for the PFD attachment effort.

Besides the collection fees reflected in Figure D on the prior page, the State also incurred indirect costs such as clerical and data processing costs to identify and process PFD attachment forms with the Department of Revenue. Additionally, ACPE had to bear the costs of the Administrative Procedures Act hearing process which was required for those borrowers who appealed the attachment of their PFDs.

Scope of Collection Effort

ACPE has continued to be concerned regarding what they believe is a lack of complete effort on the part of their contractors. Although the contractors were making collections in a cost effective manner (as discussed previously in this section) ACPE was frustrated that they were not and subsequently have not increased staff to adequately "work" a larger portion of the defaulted loan accounts.

The table below summarizes the number of loan accounts transferred to the two collection contractors through the end of 1987. As shown in the table neither contractor was successful in bringing current more than 20% of the loan accounts received.

Contractor	Estimated Net Loan Accounts Transferred as of 12/31/87	Loan Accounts Brought Current	Loan Accounts Paid in Full	Percent of Accounts Current or Paid in Full
Patterson & Van Abel	11,300	1,372	447	16.10%
Collect Alaska Network	2,000	191	24	10.75%
Totals	13,300	1,563	471	15.29%

In reviewing this table, two factors should be kept in mind. The first involves the number of long dormant accounts received by Patterson and Van Abel in the first transfer of accounts. As discussed in Recommendation No. 1 (see Findings and Recommendations section of this report) Patterson and Van Abel received over 700 dormant accounts that had had no contact or trace of the borrower for more than 2 years. If the table was adjusted to reflect these near impossible collection situations, PVA's success rate would be higher.

A second factor involves attachment of PFDs. Both contractors' "paid in full" and "brought current" totals benefit from the attachment of PFDs. That is, their "success rates" as measured above, are improved by their authority to attach defaulted borrower PFDs, a function that ACPE believes that they can carry out just as effectively.

The Default Rate

Although the default rate was a not a critical element in the initial decision to privatize collections, the recent creation of the Alaska Student Loan Corporation (ASLC) has made it a more important factor. ASLC is essentially a bonding authority established to fund student loans through the sale of tax exempt bonds. Prospectively, an increasing student loan default rate may have a critical impact on the bonds' financial rating and, accordingly, result in a higher cost of debt to ASLC.

Figure E to the right charts the default rate of student loans beginning with the the onset of privatization in January of 1985. The shaded portion of the chart represents the period that ACPE dealt with a single collection contractor (through December 1986). The unshaded portion provides perspective on what impact the use of two contractors and the attachment of PFD checks had on the default rate.

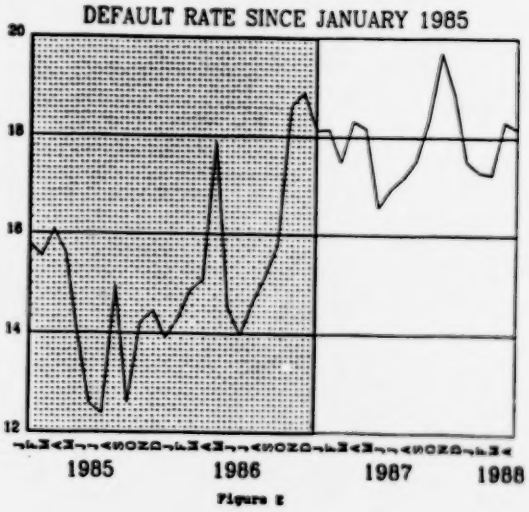

Figure E

The collections effort, although cost efficient to the state, was not reducing the default rate. The contractors were realizing a large increase in their fees for collections that now had been made much easier due to the 1987 PFD attachment legislation. ACPE felt that given the increasing default rate and the reduced "work" necessary to collect on accounts that they had to restructure the collections contracts. The new contract is designed to provide ACPE with more control over past due accounts, realize more of the PFD attachment proceeds and prospectively have more of an impact on the default rate.

FINDINGS AND RECOMMENDATION

Recommendation No. 1

ACPE should further develop and implement its policy for identifying and writing off uncollectible student loan accounts.

ACPE's current policy regarding recognition of bad debt losses (the "writing off" of loan accounts as uncollectible) has very limited application. Loan accounts are recognized as uncollectible only in instances of the borrower's death or permanent (at least 50%) medical disability. Accounts where there has been absolutely no contact or trace of borrowers for four or five years continue to be recognized as an outstanding defaulted loan.

At the December 1987 commission meeting ACPE staff presented a report which identified 771 accounts as having no contact for at least five years. If those accounts would have been written off, the default rate would have been lowered by 1%.

The law firm of Patterson and Van Abel, who has been collecting on defaulted student loans for ACPE since 1984, hold many of these no-contact accounts. Patterson and Van Abel stated that it was for the most part virtually impossible to make any effective collection effort on these long dormant accounts.

We agree with Patterson and Van Abel. If, after extensive efforts, either ACPE or the contractor has not been able to make any contact for over three to four years with the defaulted borrower, the account should be deemed as uncollectible and recognized as a bad debt expense in the loan program's financial statements.

By continuing to carry these long dormant accounts as defaulted loans the loan program's default rate is overstated and does not accurately reflect the true status of the program's loan situation.

Prior Audit Recommendation

In our audit report for the fiscal year ending June 30, 1986, "A Report on the Alaska Commission on Postsecondary Education, Scholarship Revolving Loan Fund, Teacher Scholarship Revolving Loan Fund, Memorial Scholarship Revolving Loan Fund", we made the following recommendation:

ACPE should improve internal controls and monitoring involving the collections contract[s] to properly safeguard the transferred loans receivable.

Defaulted loans transferred to the collections contractors are not adequately safeguarded or controlled. Although processing and control of these loans is the collectors' responsibility by contract, ACPE remains ultimately accountable for the safeguarding of these State assets. Accordingly ACPE must diligently monitor the defaulted loans and collections contracts to safeguard the transferred loans receivable.

Legislative Audit's Current Position

We remain concerned about the nature and extent of control that ACPE exercises over accounts held by the collection contractors. ACPE relies on status reports to determine the default rate and for other management purposes, but has not audited the reports to determine if the actual level of activity is correctly reflected. Accordingly, we have extensively used various activity reports prepared and submitted by the contractors in our analysis. Since these reports are not consistently reconciled or reviewed we cannot be certain of the degree of their reliability.

STEVE COWPER, GOVERNOR

ALASKA COMMISSION ON POSTSECONDARY EDUCATION

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LEGISLATIVE AUDIT

September 15, 1988

Mr. Randy S. Welker
Legislative Auditor
Division of Legislative Audit
P.O. Box W
Juneau, AK 99811-3300

Dear Mr. Welker:

This is to acknowledge receipt of the "CONFIDENTIAL" preliminary report: "A Special Report on the Alaska Commission on Postsecondary Education, Collection of Defaulted Student Loans, August 15, 1988." Pursuant to the request of the Legislative Budget and Audit Committee, the following is a response to the report and the recommendations.

I would like to make the initial comment that the report is an excellent and accurate representation of the issues surrounding the collections of defaulted student loan accounts by contractors. In particular, the Report Conclusions provides an exceptionally clear narrative which strikes at the heart of the matter.

Recommendation No. 1 - ACPE should further develop and implement its policy for identifying and writing off uncollectible student loan accounts.

We concur with this recommendation. At the December, 1988 meeting of the ACPE, the staff intends to recommend that those accounts residing either in the Commission office or with the contractor and for which, after extensive efforts, no contact has been made for at least four years be deemed uncollectible and recognized as a bad debt expense in the loan program's financial statements. In addition, the names of the defaulted borrowers which have been written off will be submitted to national credit bureaus. This process will provide an additional avenue for collection if the defaulted borrower applies for credit in the future.

Prior Audit Recommendation - ACPE should improve internal controls and monitoring involving the collections contract(s) to properly safeguard the transferred loans receivable.

We concur with this recommendation. Recently, a collections assistant was hired to provide the administrative support that our collections officer has so badly needed. The collections officer will now be devoting more of her time for the administration of contracts and

evaluation of the efforts of the collection agencies. Moreover, annual staff visits to the collection agencies are scheduled to enhance our ability to monitor their performance.

Again, I would like you to know that we appreciate very much the professional manner in which the audit was conducted and the subsequent well-written and comprehensive report.

Cordially,

Ronald A. Phipps

Ronald A. Phipps
Executive Director

cc: Alice Bosshard, Chair
Alaska Commission on Postsecondary Education